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EXCEPTION

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BEFORE THE ARIZONA CORPORATIO[N]

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IN THE MATTER OF THE APPLICATION OF EPCOR WATER ARIZONA, INC. FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY SERVICE BY ITS MOHAVE WATER DISTRICT, PARADISE VALLEY WATER DISTRICT, SUN CITY WATER DISTRICT, TUBAC WATER DISTRICT, AND MOHAVE WASTEWATER DISTRICT.

DOCKET NO. WS-01303A-14-0010

NOTICE OF FILING EXCEPTIONS TO RECOMMENDED OPINION AND ORDER

On behalf of the Santa Cruz Valley Citizens Council, James Patterson and Rich Bohman hereby file this set of Exceptions to the Recommended Opinion and Order dated August 7, 2015.

RESPECTFULLY SUBMITTED this 17th day of August, 2015:

Arizona Corporation Commission
DOCKETED
AUG 19 2015
DOCKETED BY

James Patterson

James S. Patterson
President
Santa Cruz Valley Citizens Council

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Exception 1 - Corporate Allocations

The Recommended Opinion and Order addresses Corporate Allocations (Page 36, Section IV, B-5) but allows excessive amounts on the basis that water districts and their customers "... receive a number of benefits related to the corporate structure." Examples given are "access to low-cost capital ...financial, technical and managerial expertise, and the ability to share certain operating expenses with other systems." This statement sounds reasonable in principle and true to a certain extent, but it ignores the multiple layers of corporate structure, which beyond Epcor Water Arizona are simply duplicative.

The Tubac Water District is overseen and receives services from Epcor Water Arizona, which is overseen by Epcor Water USA which is overseen by Epcor Utilities Inc. These two additional corporate layers provide no direct benefit to water districts.

In the expense statement for each water district, there is a line item titled "Corporate Allocations." But there is also an allocation for corporate overhead embedded in 11 of 13 other expense line items. This redundancy adds more than $100,000 to Tubac's cost structure. Further, Epcor Water Arizona pays a significant dividend each year, $10 million, to the next corporate layer; this should be more than adequate renumeration for what amounts to investment oversight.

Excessive corporate overhead that is of no direct use to the Tubac Water District becomes glaringly apparent by comparison with a nearby water system, Baca Float Water, which filed a rate increase request on December 30, 2014 (Docket #WS-01678A-14-0425). Baca Float's costs per customer and costs per million gallons pumped are significantly lower than Epcor Water's Tubac District (see Citizens Council Exhibit A - Revised, in SCVCC Surrebuttal Testimony). When the Corporate Allocation line item is removed from Epcor's cost structure, or when corporate overhead is stripped out of other line items, the costs of providing water to the two systems' customers becomes comparable and competitive.

Because of the way in which the Company's expense statements are constructed, the true extent of corporate overhead is obscured and far exceeds the single "Corporate Allocations" line item. None of the water districts in this case should be burdened with overhead for corporate layers beyond Epcor Water Arizona. A large portion of these embedded expenses should be scrutinized and disallowed.

Exception 2 - Tubac Storage Tank

The Santa Cruz Valley Citizens Council appreciates the attention given to the issue of additional storage capacity for the Tubac Water system (Page 67-68, Section VIII E of ROO). However, we continue to believe that this docket should be closed with regards to that issue. The results of a future hydraulic study should be given adequate time for consideration along with thoughtful determination of the facility's location and associated costs. The actual need for storage should be addressed in a future rate case; at that time any necessary facility should be rate-based. In the meantime, both prior case evidence and a reading of the relevant statutory language refute the claim that storage is necessary or mandated.

a. Prior Evidence - We continue to cite the 2009 case in which Staff withdrew its recommendation for storage following disclosure that an inactive well (#3) was placed back on-line (Docket No. WS-01303A-09-0152). Staff said at the time:

"On May 28, 2009, the Company informed Staff that the third well was now producing water that meets water quality standards and as a result this well was returned to service as of April 29, 2009.

"Based on this new information Staff now concludes that <u>the Tubac water system has adequate existing water production capacity</u> (810 GPM) <u>and storage capacity</u> (50,000 gallons) <u>to service existing customers plus reasonable growth</u>." [emphasis added]

In support of Staff's position, the company said in an exception to the Recommended Opinion and Order dated May 22, 2009 (filed May 28, 2009):

"...*<u>the additional capacity provided by Well #3 will then provide sufficient capacity without the need for additional storage."</u>*

Since that time, growth in the Tubac Water District has amounted to 7-8 connections. And the growth projected by Staff Engineer Michael Thompson has already been overstated by more than 16 connections (Table D, Thompson direct testimony).

Based on the evidence presented above, the need for additional storage based on current demand and reasonable growth is refuted.

b. Statutory Reading Contradicts Staff and Company Testimony - A reading of the Arizona Code (Title 18, Chapter 5, Section 503 - Storage Requirements) indicates that additional storage is not a requirement for the Tubac Water District:

"A. <u>The minimum storage capacity</u> for a CWS or a noncommunity water system that serves a residential population or a school <u>shall be equal to the average daily demand during the peak month of the year.</u> Storage capacity may be based on existing consumption and phased as the water system expands. [Tubac peak-month ave. daily demand = 297,800 gal.]

"B. <u>The minimum storage capacity for a multiple-well system</u> for a CWS or a noncommunity water system that serves a residential population or a school <u>may be reduced by the amount of the total daily production capacity minus the production from the largest producing well."</u>

During the peak month of the test year, June 2013, EWAZ reported the Tubac Water system had 8,934,000 gallons of water sold. Average daily demand for the month was determined to be 297,800 gallons per day (page 304 Staff Direct Testimony, Michael Thompson). The calculation of required storage based on Arizona Code is:

Step 1: The production of the three wells in the Tubac District is:

450 gpm (well 5)

350 gpm (well 4)

130 gpm (well 3)

Total: 930 gpm

Step 2: Total Daily Production = 930 gpm x 60 minutes = 55,800 gph, x 24 hours = 1,339,200 gallons per day.

Step 3: Largest producing well #5 produces: 450 gym x 60 minutes x 24 hours = 648,000 gallons per day

Step 4: Minimum storage = peak-month average daily demand = 297,800 gpd

Step 5: Min. Storage Capacity *reduced by* Total Daily Production *minus* Largest Well Production

297,800 gpd - (1,339,200 gpd - 648,000) = *negative* 393,400

Conclusion: no storage required under Arizona Code, Title 18, Chapter 5, Section 503

The issue of storage should be considered for inclusion in the next rate case. This docket should be closed with regards to storage.

Exception 3 - Tubac Water District Cost of Capital

We advocated for a separate cost of capital for the Tubac Water District based on the high proportion of long-term debt represented by our WIFA loan, for which we wrote and secured the grant. Thus, we were pleased with the conclusion in the ROO supporting that position (Pages 37-39, 41-43, Section V, A,B,D). However, we disagree with the slightly lower debt to higher equity ratio assigned to Tubac Water District. This has the effect of reducing the impact of the WIFA loan on the total weighted cost of capital from 30 basis points to 11 basis points. The different debt/equity percentages assigned to Tubac appears to be due to the outstanding amortized amount of the WIFA loan as of December 30, 2014. However, all debt, equity and coupon rates are amounts which were established and determined by the test year. This is the period in which the WIFA loan amount should be fixed too.

We ask that in the Final Decision, the full 30-basis-point spread between the Tubac Water District's cost of capital and other districts' cost of capital be recognized (ref. Citizens Council

Exhibit B- Cost of Capital, submitted with Summary Testimony at ACC Hearings, March 10, 2015. This Exhibit does not recommend any specific weighted cost of capital, but rather establishes a rationale for the 30-basis-point spread).

Exception 4 - Phase-in of Rate Increase

The SCVCC takes exception to the ROO's disallowance (page 51, section VII, C) of a phase-in of the allowed rate increase (more than a 48% increase for the average residential user) over a three-year period.

The SCVCC asked for a phase-in period of three years, with no recovery of foregone revenue by the Company, due to the financial shock that Epcor's Tubac customers will experience. In addition to the allowed rate increase, Epcor's Tubac customers face a three-year surcharge to pay back deferred, accumulated arsenic media expenses totaling $101,000, plus the potential for increased power cost adjustments. Thus, the average residential consumer's prospective bill of $79.42 per month will actually be higher - i.e. more than the 48.3% nominal increase allowed by the ROO.

We note that Tubac consumers face these extraordinarily high rates for at least four years, and then would have relief only if rate consolidation were to be approved and implemented. The SCVCC has been a proponent of consolidation and we are encouraged that the ROO includes a directive for Epcor Water Arizona to file a rate case with a consolidated rate scenario no later than July 1, 2018 (page 50, section VII, B).

In the meantime, the rate increase allowed for the Tubac Water District should and will be viewed as "rate shock," a primary reason why a phased-in approach should be granted to consumers. Such a phase-in has precedent: In the Global Water rate case (DOCKET NO. W-01212A-12-0309 ET AL., Decision 74364), the parties agreed to a phase-in period of three to eight years, with no recovery of foregone revenue or carrying costs.

We ask that the final decision in this case include a phase-in period for the Tubac Water District to mitigate the sudden impact of what will be by far some of the highest water rates in Arizona. In good faith, Epcor should agree to this concession, as did the parties in the Global Water case.

Exception 5 - Declining Usage Adjustment

The Recommended Opinion and Order grants the Company's request for a declining usage adjustment (Page 49, Section VII, paragraph A). For Tubac, this is calculated as a *projected* 6.7% decline, a decrease that is anywhere from two to 12 times that projected for other water districts in this case. Paradoxically, in this same case we are facing a potential requirement for storage predicated in part on "reasonable growth"; yet we are also facing a one-way, built-in inflation to our monthly minimum charge based on declining usage.

While it may be true that the magnitude of the rate increase allowed in this case may lead to declining usage per customer, many of the easy consumption remedies have already been implemented following the last round of rate increases. There is already a vivid awareness of the high cost of water here in Tubac. A second round of declining usage like the one this 6.7% adjustment is predicated upon is unlikely. More likely is a scenario where added connections and use offset attempts to further conserve by existing consumers.

Most troubling however, is that there is no mechanism to account for variations in the 6.7% declining usage projection. This projection is built in to the Tubac District's monthly minimum charge for at least the next three years or until a decision in the next rate case becomes effective.

We ask that a mechanism be included, as RUCO recommended, that assures relief in the event that usage does not decline according to projections, or if growth increases overall demand. This is referred to as a "true-up," and should be considered a basic and reasonable protection for consumers in this case.

Exception 6 - Rate Design

We disagree with the apparent conclusion in the ROO (Page 47-48, Section VII) that all of second-tier usage (3,000-10,000 gallons) is discretionary, thus providing a basis for increasing the spread between the first and second tiers ("the spread between the first and second tier was increased - converting a portion of revenues from non-discretionary to discretionary" pg. 48). Further, this logic seems contradictory to the balance of the Order to *decrease* the spread between the third and fourth tiers. Usage in theory should become more discretionary at increasing levels, and therefore price signals should be sent by increasing spreads at higher levels. When the tier structure is flattened it deters conservation.

We believe that the monthly minimum charge is overloaded in the Company's favor. We note that the increase in the monthly minimum charge is 58%, from $24.70 per month to $39.00 per month, and that this increase is significantly more than either Staff or RUCO suggested in their final proposals. Shifting the revenue requirement to a guaranteed source is contradictory to the goal of encouraging conservation.

The rate design in the Final Decision should include less reliance on a monthly minimum by reducing that amount at least to the level suggested in final briefs by Staff ($35.77), and that the commodity charge should be increased between the third and fourth tiers to compensate and match required revenue.

Exception 7 - Magnitude of Rate Increase

We note with dismay that the Recommended Opinion and Order establishes rates that exceed both RUCO's and Staff's recommendations.

The monthly minimum charge of $39.00 exceeds Staff's $35.77 by 9%. It exceeds RUCO's by 23%. The average residential bill resulting from the ROO ($79.42) exceeds Staff's recommendation of $74.63 by more than 6%, and RUCO's $67.32 by 18%. These amounts don't include the added PCAM and Arsenic Media Amortization costs.

Ironically, the aquifer beneath the Tubac District's wells are part of the Santa Cruz Active Management Area (SCAMA), the only Arizona Department of Water Resources AMA that is self-sustaining — yet we pay more than any other district in Arizona.

We believe that the Final Decision establishing rates should respect Staff and RUCO's expertise and diligence, as well as RUCO's balanced efforts to protect utility consumers.

Dated this ____ day of August 2015.

James S. Patterson

President Santa Cruz Valley Citizens Council

ORIGINAL and thirteen (13) copies of the foregoing will be filed the ____ day of August 2015 with Docket Control

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